

Letter of Findings: 04-20110489; 04-20110412
Gross Retail Tax
For the Years 2008, 2009, and 2010

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ISSUES

I. Nonlegend Drugs – Gross Retail Tax.

Authority: IC § 6-2.5-1-17; IC § 6-2.5-1-2; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-4-1(b), (c); IC § 6-2.5-5-17(3); IC § 6-2.5-5-19 (2003); IC § 6-2.5-5-19(d); IC § 6-2.5-5-19 (1980); IC § 6-2.5-5-19(d)(2); IC § 16-42-19-3; [45 IAC 2.2-5-35](#) (1982); [45 IAC 2.2-5-36](#) (1982); *Rhoades v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629 (Ind. Tax Ct. 1999); *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282 (Ind. Tax Ct. 1999); *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399 (Ind. Tax Ct. 1991); *Indiana Dept. of State Rev. v. Kimball Int'l Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974).

Taxpayer argues that its purchases of nonlegend drugs such as lotions and ointments were not subject to sales or use tax.

II. Medical Supplies and Equipment – Gross Retail Tax.

Authority: IC § 6-2.5-5-18; IC § 6-2.5-5-18(a); IC § 6-8.1-5-1(c); [45 IAC 2.2-5-27](#); [45 IAC 2.2-5-27\(b\)](#); [45 IAC 2.2-5-28](#); [45 IAC 2.2-5-36](#); [45 IAC 2.2-5-36\(a\)\(4\)](#); [45 IAC 2.2-5-36\(a\)\(5\)](#); Sales Tax Information Bulletin 48 (August 2008).

Taxpayer maintains that its purchase of various medical supplies and equipment were not subject to sales or use tax.

STATEMENT OF FACTS

This Letter of Findings addresses protests submitted by two different but related Indiana entities. The first entity is described as providing "nursing and hospice care in a variety of settings including nursing facilities, homes and residential services facilities." More generally, the first entity provides services that fall into two broad categories of "hospice care and home health care."

This Letter of Findings also addresses issues raised by a second but related entity. This entity is a limited partnership that operates a for-profit hospital. This entity "provides acute, long-term care to patients who required extended hospitalizations."

For convenience sake – and because both entities raise identical issues – the two entities are hereinafter referred to simply as "Taxpayer."

The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's business records. The audit resulted in the assessment of additional sales/use tax. Taxpayer disagreed with a portion of the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative explained the basis for the protest. This Letter of Findings results.

I. Nonlegend Drugs – Gross Retail Tax.

DISCUSSION

The Department found that Taxpayer had purchased "non-prescription lotions and ointments" and that these purchases were subject to Indiana's sales/use tax. As explained in the audit report:

There are numerous exemptions for medical supplies and equipment provided by Indiana statutes and regulations. However, in general these exemptions apply to patients. In this instance, the [T]axpayer is provider of medical services, not a patient. (Emphasis in original).

Taxpayer maintains that the Department's audit erred when it determined that its purchases of these "non-prescription lotions and ointments" were subject to sales/use tax.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax called the "use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that

transaction." IC § 6-2.5-3-2(a). Use means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See *Rhoades v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002). By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. *Rhoades*, 774 N.E.2d at 1047; *USAir, Inc. v. Ind. Dep't of State Revenue*, 623 N.E.2d 466, 468-69 (Ind. Tax Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. *Rhoades*, 774 N.E.2d at 1048. A taxable retail transaction occurs when; (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-4-1(b), (c).

Nonetheless, Taxpayer argues that its purchases of the various lotions and ointments were "nonlegend drugs" and fall within the exemption set out in IC § 6-2.5-5-19 (2003) as follows:

- (a) As used in this section, "legend drug" means a drug as defined in [IC 6-2.5-1-17](#) that is also a legend drug for purposes of [IC 16-18-2-199](#).
- (b) As used in this section, "nonlegend drug" means a drug (as defined in [IC 6-2.5-1-17](#)) that is not a legend drug.
- (c) Sales of legend drugs and sales of nonlegend drugs are exempt from the state gross retail tax if:
 - (1) a registered pharmacist makes the sale upon the prescription of a practitioner who is licensed to prescribe, dispense, and administer those drugs to human beings or animals in the course of his professional practice; or
 - (2) the licensed practitioner makes the sales.
- (d) Sales of a nonlegend drug are exempt from the state gross retail tax, if:**
 - (1) the nonlegend drug is dispensed upon an original prescription or a drug order (as defined in [IC 16-42-19-3](#)); and**
 - (2) the ultimate user of the drug is a person confined to a hospital or health care facility.**
- (e) Sales of insulin, oxygen, blood, or blood plasma are exempt from the state gross retail tax, if the purchaser purchases the insulin, oxygen, blood, or plasma for medical purposes.
- (f) Sales of drugs, insulin, oxygen, blood, and blood plasma are exempt from the state gross retail tax if:**
 - (1) the purchaser is a practitioner licensed to prescribe, dispense, and administer drugs to human beings or animals; and**
 - (2) the purchaser buys the items for:**
 - (A) direct consumption in his practice; or**
 - (B) resale to a patient that the practitioner is treating, in the case of sales of legend or nonlegend drugs.**

(Emphasis added).

IC § 6-2.5-5-19 (2003) like all tax exemption provisions, is strictly construed against exemption from the tax. *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999); *Mysnberge v. Dep't of State Revenue*, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999); *Indiana Dept. of State Rev. v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id.* at 100-101.

Nevertheless, the Department is well aware of the countervailing rule that a "statute must not be construed so narrowly that it does not give effect to legislative intent because the intent of the legislature embodied in a statute constitutes the law." *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991).

In making its argument that it was entitled to purchase the lotions and ointments without paying sales tax, Taxpayer points to a previous version of IC § 6-2.5-5-19 (1980) which states:

- (a). Sales of drugs are exempt from the state gross retail tax, if;
 - (1) a registered pharmacist makes the sale upon the prescription of a practitioner who is licensed to prescribe, dispense, and administer those drugs to human beings in the course of his professional practice; or
 - (2) the licensed practitioner makes the sales.
- (b). Sales of insulin, oxygen, blood, or blood plasma are exempt from the state gross retail tax, if the purchaser purchases the insulin, oxygen, blood, or plasma for medical purposes.
- (c). Sales of drugs, insulin, oxygen, blood, and blood plasma are exempt from the state gross retail tax, if:
 - (1) The purchaser is a practitioner licensed to prescribe, dispense, and administer drugs to humans or animals;
 - (2) The purchaser buys the items for direct consumption in his practice; and
 - (3) In the case of sales of drugs, the drugs may not be sold without a prescription.

Under IC § 6-2.5-5-19 (1980), a licensed practitioner's purchase of drugs was exempt when the drugs were purchased for direct consumption by the practitioner and the drugs could not be sold without a prescription. Under IC § 6-2.5-5-19 (1980), the legislature intended that only prescription drugs that were directly consumed by a licensed practitioner were exempt from Indiana sales/use tax.

The Department of Revenue issued regulations in 1982 addressing the issue of whether the purchase or sale of drugs is subject to sales/use tax.

[45 IAC 2.2-5-35](#) (1982) provides:

(a) In general, all purchases of tangible personal property by a licensed practitioner are subject to gross retail tax. This exemption is limited to sales of certain drugs, insulin, oxygen, blood and blood plasma.

(b) Sales to licensed practitioners, of drugs which may be sold only on a prescription are exempt from the gross retail tax if the practitioner buys the drugs for direct consumption in the course of rendering professional services.

(c) Sales to licensed practitioners of insulin, oxygen, blood, or blood plasma are exempt from the gross retail tax if the practitioner buys such items for direct consumption in the course of rendering professional service.

[45 IAC 2.2-5-36](#) (1982) provides:

(a) The gross retail tax shall apply to the following purchase transactions made by licensed practitioners:

(1) All office furniture, equipment and supplies.

(2) Drugs of a type not requiring a prescription, when not purchased for resale.

(3) Surgical instruments, equipment and supplies.

(4) Bandages, splints, and all other medical supplies consumed in professional use.

(5) X-Ray, diathermy, diagnostic equipment, or any other apparatus used in the practice of surgery or medicine.

(b) The purchase of items for resale by the physician or surgeon. In order to resell items the practitioner must be licensed as a retail merchant, and must quote the selling price of any items separately from the charge for professional service.

[45 IAC 2.2-5-35](#) (1982) and [45 IAC 2.2-5-36](#) (1982), practitioners were entitled to purchase drugs without incurring sales/use tax. However, the exemption was only applicable to prescription drugs. If the drugs could be purchased without a prescription – such as "nonlegend" drugs – the exemption was not applicable. The only way a practitioner could purchase nonlegend drugs without paying tax was to purchase the drugs under a more general "purchase for resale" exemption, e.g. a doctor purchases aspirin to sell to the patients who visit her clinic.

It is Taxpayer's contention that the Department's regulations no longer accurately reflect the underlying legislative intent set out in IC § 6-2.5-5-19 (2003). Taxpayer points out that the legislature modified IC § 6-2.5-5-19 (1980) in 1994 and subsequently in 2003 and that the modifications entitle it to purchase nonlegend drugs without paying sales/use tax. Specifically, Taxpayer points to IC § 6-2.5-5-19(d) (2003) which states:

(d) Sales of a nonlegend drug are exempt from the state gross retail tax, if:

(1) the nonlegend drug is dispensed upon an original prescription or a drug order (as defined in [IC 16-42-19-3](#)); and

(2) the ultimate user of the drug is a person confined to a hospital or health care facility.

Insofar as Taxpayer's protest, "nonlegend" drugs are defined under IC § 6-2.5-1-17 as follows:

"Drug" means a compound, substance, or preparation and any component of a compound, substance, or preparation that is:

(1) recognized in the official United States Pharmacopoeia, official Homeopathic Pharmacopoeia of the United States, or official National Formulary, and supplement to any of them;

(2) intended for use in the diagnosis, cure, mitigation, treatment, or prevention of disease; or

(3) intended to affect the structure or any function of the body.

The term does not include food and food ingredients, dietary supplements, or alcoholic beverages.

(Emphasis added).

Taxpayer maintains that its purchase of topical substances – such as protective lotions, ointments, moisturizing cream – are nonlegend drugs and fall within the exemption set out in IC § 6-2.5-5-19 (2003). Taxpayer is correct. The lotions and ointments fall within the definition of "drugs" under IC § 6-2.5-5-17(3) because they cure, mitigate or treat disease or "affect the structure or any function of the body," are prescribed pursuant to IC § 16-42-19-3, and "the ultimate user of the drug is a person confined to a hospital or health care facility." IC § 6-2.5-5-19(d)(2) (2003). However, it should be noted that the exemption does not cover the use of nonlegend drugs outside of Taxpayer's facility. To the extent that Taxpayer can differentiate between the use of the nonlegend drugs inside its facility and outside its facility – providing "home health care" – Taxpayer's protest is sustained.

FINDING

Taxpayer's protest is sustained.

II. Medical Supplies and Equipment – Gross Retail Tax.

DISCUSSION

The audit found that Taxpayer purchased IV supplies, syringes, catheters, and tubing without paying sales

tax. The audit assessed tax concluding that, "Supplies, equipment, and devices used or consumed by a practitioner in rendering medical treatment do not qualify for exemption from sales tax...."

The audit cited to Sales Tax Information Bulletin 48 (August 2008), 20080827 Ind. Reg. 045080661NRA, which states:

In general, all purchases of tangible personal property by a licensed practitioner are subject to sales tax. However, an exemption is afforded to purchases of certain drugs, insulin, oxygen, blood, and blood plasma. Purchases by licensed practitioners of drugs that can be sold only by prescription are exempt from sales tax if the practitioner buys the drugs for direct consumption in the course of rendering professional services. Purchases by licensed practitioners of insulin, oxygen, blood, and blood plasma are exempt from the sales tax if the practitioner buys such items for direct consumption in the course of rendering professional services. Drugs, insulin, oxygen, blood, and blood plasma consumed in the course of rendering professional services are those drugs, etc., that are administered by a licensed practitioner or agent including the furnishing of such drugs as a part of a single charge for professional service. (Emphasis added).

The audit report noted that, "with the help from the [T]axpayer, worked to ensure that no assessment was made for the purchase of any of the enumerated exempt items...."

Taxpayer indicates that it relied upon previous guidance by the Department instructing it that the purchase of medical supplies was exempt. As specific statutory authority for its position that the purchase of the equipment and supplies was exempt, Taxpayer cites to IC § 6-2.5-5-18 which states:

(a) Sales or rentals of durable medical equipment, mobility enhancing equipment, prosthetic devices, artificial limbs, orthopedic devices, dental prosthetic devices, eyeglasses, contact lenses, and other medical supplies and devices are exempt from the state gross retail tax, if the sales or rentals are prescribed by a person licensed to issue the prescription.

(b) Sales of hearing aids are exempt from the state gross retail tax if the hearing aids are fitted or dispensed by a person licensed or registered for that purpose. In addition, sales of hearing aid parts, attachments, or accessories are exempt from the state gross retail tax. For purposes of this subsection, a hearing aid is a device which is worn on the body and which is designed to aid, improve, or correct defective human hearing.

(c) Sales of colostomy bags, ileostomy bags, and the medical equipment, supplies, and devices used in conjunction with those bags are exempt from the state gross retail tax.

(d) Sales of equipment and devices used to administer insulin are exempt from the state gross retail tax.

(e) Sales of equipment and devices used to monitor blood glucose level, including blood glucose meters and measuring strips, lancets, and other similar diabetic supplies, are exempt from the state gross retail tax, regardless of whether the equipment and devices are prescribed.

Therefore, sales of "durable medical equipment" and supplies may be exempt if the equipment is "prescribed." (The statute also specifically exempts certain items such as diabetic supplies whether or not they are prescribed.) The Department's regulation, [45 IAC 2.2-5-27](#), explains:

(a) The term "person licensed to issue a prescription" shall include only those persons licensed or registered to fit and/or dispense such devices. (b) Definition: The term "prescribed" shall mean the issuance by a person described in paragraph 1 of this regulation [subsection (a) of this section] of a certification in writing that the use of the medical equipment supplies and devices is necessary to the purchaser in order to correct or to alleviate a condition brought about by injury to, malfunction of, or removal of a portion of the purchaser's body. (Emphasis added).

Under IC § 6-2.5-5-18(a) and [45 IAC 2.2-5-27](#), a person having a "condition brought about by injury, malfunction of, or removal of a portion of the purchaser's body," may be eligible for a sales tax exemption if the "person" receives a proper prescription for the "medical equipment supplies and devices."

Under IC § 6-2.5-5-18(a) and [45 IAC 2.2-5-28](#), sales of prescribed "medical equipment, supplies, or devices" are exempt if they are necessary to "correct or alleviate injury to, malfunction of, or removal of a portion of the purchaser's body."

In this case, the transactions were between Taxpayer and its various vendors. Taxpayer was the purchaser but did not sustain a "condition brought about by injury to, malfunction of, or removal of a portion of the purchaser's body." See [45 IAC 2.2-5-27\(b\)](#).

Taxpayer provides hospice and long-term medical care; its purchases of the IV supplies, syringes, catheters, and tubing transactions are more appropriately addressed at [45 IAC 2.2-5-36](#) which states:

(a) The gross retail tax shall apply to the following purchase transactions made by licensed practitioners:

(1) All office furniture, equipment and supplies.

(2) Drugs of a type not requiring a prescription, when not purchased for resale.

(3) Surgical instruments, equipment and supplies.

(4) Bandages, splints, and all other medical supplies consumed in professional use.

(5) X-Ray, diathermy, diagnostic equipment, or any other apparatus used in the practice of surgery or medicine.

(b) The purchase of items for resale by the physician or surgeon. In order to resell items the practitioner must be licensed as a retail merchant, and must quote the selling price of any items separately from the charge for

professional service. (Emphasis added).

The IV supplies, syringes, catheters, and tubing fall within [45 IAC 2.2-5-36\(a\)\(5\)](#) as "apparatus used in the practice of surgery or medicine" and are plainly "medical supplies consumed in professional use" as defined under [45 IAC 2.2-5-36\(a\)\(4\)](#). There is no indication that any of the items were ever resold to individual patients or that Taxpayer – as a hospice and long-term medical care facility– ever quoted its patients a selling price for these items.

According to Taxpayer that IC § 6-2.5-5-18, "permits hospitals to purchase all items listed in the statute tax-exempt, so long as such purchased under a doctor's orders (prescription)." As explained by Taxpayer, "[A]ll medical supplies, equipment and other items used on patients, at some or another must be verbally ordered by or approved by a licensed physician."

The Department does not agree with Taxpayer's conclusion but points to [45 IAC 2.2-5-27\(b\)](#) which explains: The term "prescribed" shall mean the issuance by a person described in paragraph 1 of this regulation [subsection (a) of this section] of a certification in writing that the use of the medical equipment supplies and devices is necessary to the purchaser in order to correct or to alleviate a condition brought about by injury to, malfunction of, or removal of a portion of the purchaser's body.

[45 IAC 2.2-5-27\(b\)](#) plainly states that, in order to qualify for the exemption, the use of the medical equipment supplies and devices is necessary to the purchaser in order to correct or to alleviate a condition brought about by injury to, malfunction of, or removal of a portion of the purchaser's body. In this case, the purchaser is Taxpayer. Taxpayer is an extended care facility and has no body upon which medical equipment, supplies, or devices may be used. Rather, Taxpayer purchases the equipment and uses it in providing medical services to its patients. Taxpayer has failed to meet its burden under IC § 6-8.1-5-1(c) of demonstrating that the proposed assessment was wrong.

FINDING

Taxpayer's protest is respectfully denied.

SUMMARY

Taxpayer's protective lotions, ointments, moisturizing cream are nonlegend drugs, are consumed in its medical practice, and are exempt from sales/use tax. Taxpayer's purchase of IV supplies, syringes, catheters, and tubing is not exempt.

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